BANK OF CANADA
BANQUE DU CANADA

Business Outlook Survey

Conducted by the Bank's Regional Offices

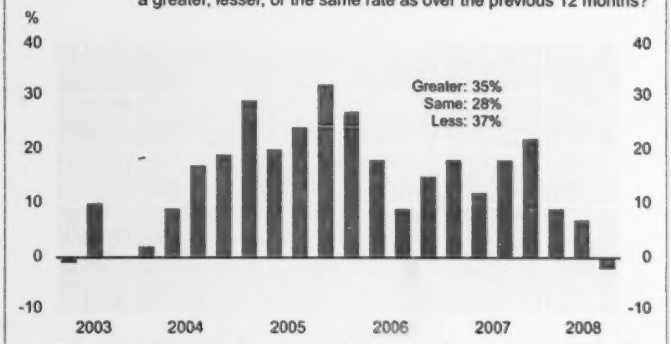
Results of the Autumn 2008 Survey — Vol. 5.3 10 October 2008

Overview

- Responses to the autumn survey indicate that the combination of weak U.S. demand, volatile financial markets, and slowing momentum in the West are weighing more heavily on business activity in Canada.
- Firms reported a less robust sales performance over the past year than in recent surveys, and they are expecting little change in the pace of sales growth over the next 12 months. Moreover, they noted a higher level of uncertainty about sales prospects. Intentions to increase investment remain solid, however.
- Pressures on production capacity are little changed from the summer survey, and declines in commodity prices have helped relieve expected price pressures. Inflation expectations have also eased slightly, but remain elevated.
- The percentage of firms reporting tighter credit conditions moved up sharply.

Chart 1 **Past Sales Growth: Balance of Opinion***

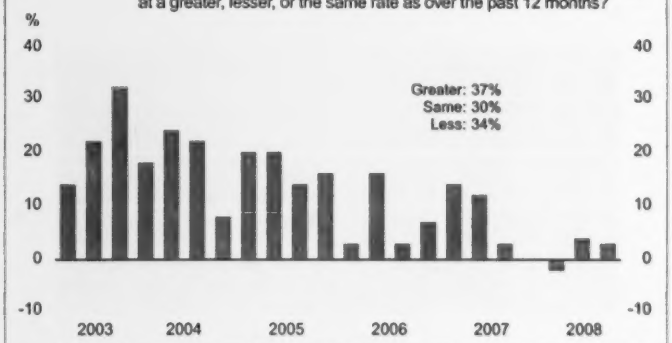
Over the past 12 months, did your firm's sales volume increase at a greater, lesser, or the same rate as over the previous 12 months?



* Percentage of firms reporting faster growth minus percentage reporting slower growth

Chart 2 **Future Sales Growth: Balance of Opinion***

Over the next 12 months, is your firm's sales volume expected to increase at a greater, lesser, or the same rate as over the past 12 months?



* Percentage of firms expecting faster growth minus percentage expecting slower growth

Business Activity

For the first time since 2003, the balance of opinion on past sales growth is just below zero **(Chart 1)**. Many firms cited a softening in demand—especially those most exposed to the U.S. slowdown—while some in the West noted that previous high rates of sales growth could not be maintained. The balance of opinion on future sales remains near zero **(Chart 2)**, suggesting that firms expect little change in the pace

The Business Outlook Survey summarizes interviews conducted by the Bank's regional offices with the senior management of about 100 firms selected in accordance with the composition of Canada's gross domestic product. The survey's purpose is to gather the perspectives of these businesses on topics of interest to the Bank of Canada (such as demand and capacity pressures) and their forward-looking views on economic activity. Additional information on the survey and its content is available on the Bank of Canada's website at <www.bankofcanada.ca/en/bos/index.html>. The autumn 2008 survey was conducted from 25 August to 19 September 2008.

The opinions expressed are those of the respondents and do not necessarily reflect the views or policies of the Bank of Canada. The method of sample selection ensures a good cross-section of opinion. Nevertheless, the statistical reliability of the survey is limited, given the small sample size.

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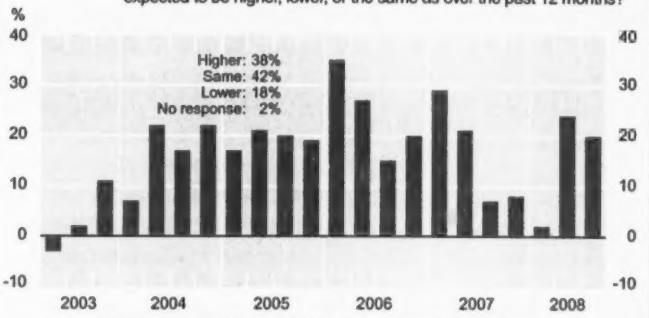
of sales growth over the next 12 months. There was an increase in the number of firms reporting that the weak outlook for the U.S. economy was negatively affecting their sales prospects, and more firms cited downside risks to their sales outlook owing to uncertainty about economic and financial conditions.

The balance of opinion on investment spending edged down **(Chart 3)** but remains solidly positive in spite of the more uncertain economic outlook. Firms planning to increase investment over the next 12 months are doing so mainly to expand their operations, reflecting the favourable long-term outlook for commodity prices or efforts to expand into new markets. Nonetheless, the financial market turmoil has caused some firms to curtail their current or longer-term investment plans.

The balance of opinion on employment is also positive but slightly below levels in recent surveys **(Chart 4)**. Hiring intentions are lower among firms located in Central and Eastern Canada than among those based in Western Canada.

Chart 3 Investment in Machinery and Equipment: Balance of Opinion*

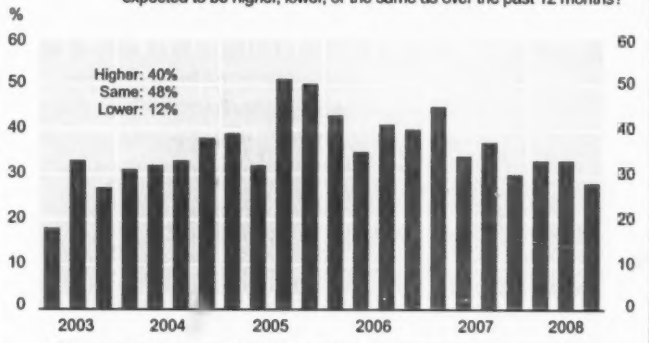
Over the next 12 months, is your firm's investment spending on M&E expected to be higher, lower, or the same as over the past 12 months?



* Percentage of firms expecting greater investment minus the percentage expecting less investment

Chart 4 Future Employment Level: Balance of Opinion*

Over the next 12 months, is your firm's level of employment expected to be higher, lower, or the same as over the past 12 months?



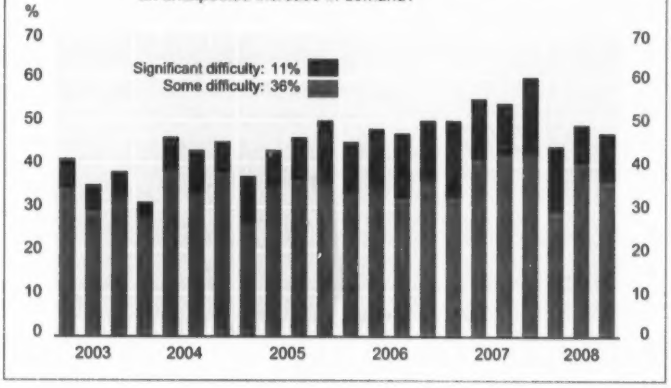
* Percentage of firms expecting higher levels of employment minus the percentage expecting lower levels

Pressures on Production Capacity

The percentage of firms reporting that they would have difficulty meeting an increase in demand was essentially unchanged from its level in the summer survey **(Chart 5)**. Firms located in Western Canada continue to be more affected by capacity constraints than those based in Central and Eastern Canada.

Chart 5 Ability to Meet Demand

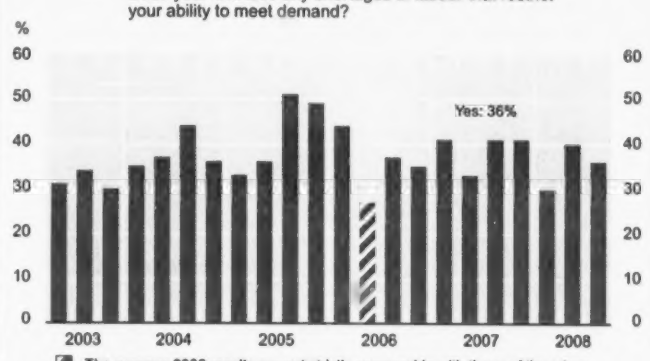
How would you rate the current ability of your firm to meet an unexpected increase in demand?



The balance of opinion can vary between +100 and -100. Percentages may not add to 100 because of rounding.

Chart 6 Labour Shortages

Does your firm face any shortages of labour that restrict your ability to meet demand?

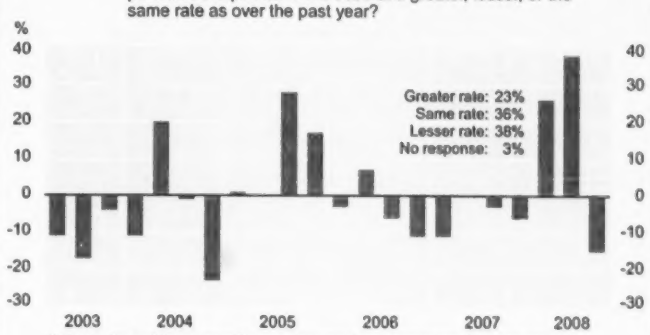


The summer 2006 results are not strictly comparable with those of the other surveys, owing to a difference in the interview process for that survey.

The percentage of firms reporting that labour shortages are restricting their ability to meet demand fell modestly **(Chart 6)**, owing to fewer reports of shortages among firms based in Central and Eastern Canada. Labour constraints continue to be most pronounced among firms in Western Canada. Overall, firms reported that labour shortages were less intense now than in the past, reflecting slower demand.

Chart 7 Input Price Inflation: Balance of Opinion*

Over the next 12 months, are prices of products/services purchased expected to increase at a greater, lesser, or the same rate as over the past year?



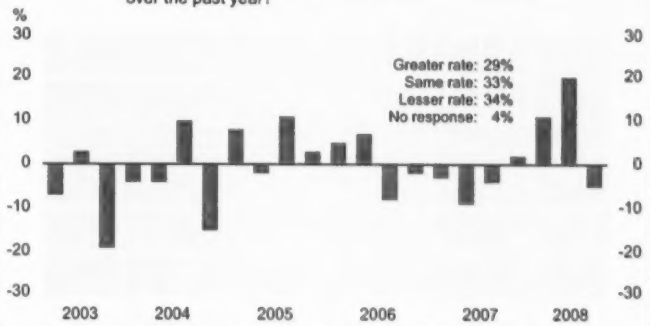
* Percentage of firms expecting greater price increases minus the percentage expecting lesser price increases

Prices and Inflation

Following a strong positive level in the summer survey, the balance of opinion on input prices is now negative **(Chart 7)**, suggesting that, on balance, firms expect their input prices to increase at a slower pace than over the past 12 months. Declining prices for energy and other commodities, leading up to and during the survey period, led firms to expect the rise in input prices to slow from its pace over the past 12 months. Despite the negative balance overall, some firms continued to report that rising prices for Chinese imports were putting upward pressure on input costs.

Chart 8 Output Price Inflation: Balance of Opinion*

Over the next 12 months, are prices of products/services sold expected to increase at a greater, lesser, or the same rate as over the past year?



* Percentage of firms expecting greater price increases minus the percentage expecting lesser price increases

The balance of opinion on output prices has fallen to a level just below zero **(Chart 8)**, indicating that, on balance, firms expect their output prices to grow at about the same pace as over the past 12 months. In some cases, the firm's desire to restore profit margins was mitigating the effect of the anticipated deceleration in input-price growth on expectations for output prices. Firms most affected by the cost of Chinese imports were expecting their output prices to grow at a faster rate over the coming year.

Inflation expectations have eased slightly across most sectors and regions **(Chart 9)**. Nonetheless, nearly one-third of firms were still expecting inflation to be above the Bank's inflation-control range of 1 to 3 per cent over the next two years. Firms with this view often cited concerns that energy prices remain high in spite of recent declines, and some expected to see lagged effects from past price increases.

Chart 9 Inflation Expectations

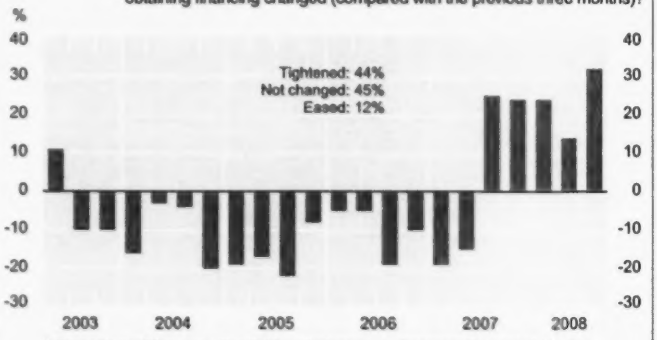
Over the next two years, what do you expect the annual rate of inflation to be, based on the consumer price index?

Credit Conditions

The balance of opinion on credit conditions reached a record-high level for the survey, with significantly more firms reporting tighter credit conditions than those reporting that conditions had eased **(Chart 10)**. Firms in both the goods and services sectors reported a more restrictive environment for obtaining financing.

Chart 10 Credit Conditions: Balance of Opinion*

Over the past three months, how have the terms and conditions for obtaining financing changed (compared with the previous three months)?



* Percentage of firms reporting tightened minus percentage reporting eased. For this question, the balance of opinion excludes firms that responded "not applicable."

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